External audit report 2016/17

Nottingham City Council

–

September 2017

Summary for Audit Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Nottingham City Council ('the Authority').

This report focusses on our on-site work which was completed in June through to September 2017 on the Authority's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on page 5.

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Authority's financial statements before the deadline of 30 September.

We will provide a verbal update on the status of our audit at the Audit Committee meeting but would highlight that at time of writing the following work is still outstanding:

- Clarification of remaining audit queries;
- Group Accounts consolidation;
- Resolution of the impact of estimated pensions data;
- Final director review of the financial statements;
- Management representation; and
- Finalisation procedure.

Our audit of the Authority's financial statements has not identified any audit adjustments which impact on the General Fund or HRA. We have identified two audit adjustments which relate to balance sheet classification with a total value of £11.53 million. See page 12 for details.

We have agreed a small number of presentational adjustments.

Based on our work, we have raised four recommendations, none of which are considered high priority, one is rated medium priority in regards to timely removal of leavers from the Northgate system. Details on our recommendations can be found in Appendix 1.

We are now in the completion stage of the audit and anticipate issuing our completion certificate and Annual Audit letter in September 2017.

Use of resources

We have completed our risk-based work to consider whether in all significant respects the Authority has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources, whilst noting the current pressures and need for action within 2017/18.

We therefore anticipate issuing an unqualified value for money opinion.

See further details from page 16.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

We ask the Audit Committee to note this report.

The key contacts in relation to our audit are:

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Contents

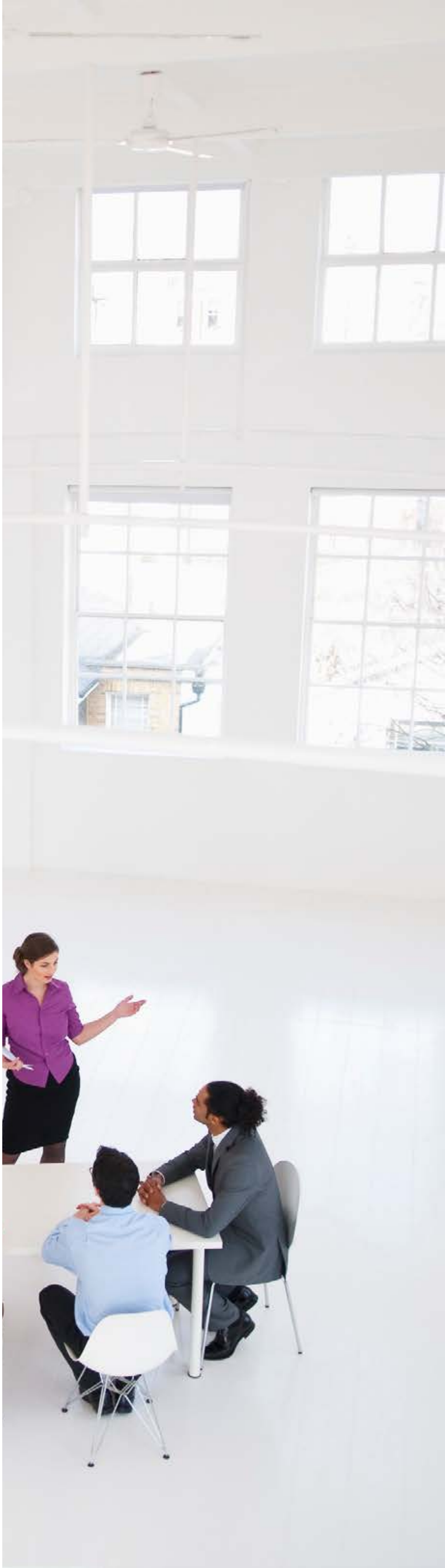
Section one

Financial Statements

We anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements by 30 September 2017. We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*'Delivering Good Governance in Local Government'*) published in April 2016.

For the year ending 31 March 2017, the Authority has reported an overspend of £2.52m against the General Fund revenue budget.

Overall there has been a £2.41m reduction on the General Fund balance and HRA balances.



Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Authority's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
1. Significant changes in the pension liability due to LGPS Triennial Valuation	**Why is this a risk?** During the year, the Local Government Pension Scheme for Nottinghamshire County (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2016 in line with the Local Government Pension Scheme (Administration) Regulations 2013. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation. The pension liability numbers to be included in the financial statements for 2016/17 will be based on the output of the triennial valuation rolled forward to 31 March 2017. For 2017/18 and 2018/19 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Nottinghamshire County Council, who administer the Pension Fund. **Our work to address this risk** We note that the data used by the actuary to perform their triennial revaluation required three years' worth of pensionable salary data, for 2013/14, 2014/15 and 2015/16. Whilst actual data was used for the first two years, the actuary confirmed to us that 14% of the data for this Authority for 2015/16 contained estimates for pensionable salaries, as opposed to actual salary data. This was due to system interface issue with the Authority's payroll system and the Pension Fund Administrator's database. We have needed to follow this up with the Authority's officers and the Pension Fund Actuary, and then consult with our KPMG pensions team. At time of writing we are waiting on further assurance from the Authority's actuary that the use of estimated data has not led to a material impact on the accounts. We have agreed the data provided by the Authority to the Actuary, back to relevant systems and reports and in turn agreed the total figures as per the IAS19 report received from the actuary to the accounts. Our KPMG Actuary team have reviewed the assumptions used by the Scheme Actuary to assess whether the assumptions (such as the discount rate) are appropriate. Our KPMG Actuary team have concluded that overall they consider the assumptions to be reasonable. Additionally, we have engaged with the Pension Fund auditors to gain further assurance over the pension figures. There are no issues to note.

Significant audit opinion risks	Work performed
2. Group accounts – significance of subsidiaries. ***Please note we have added this risk to our audit programme after we had issued our 2016/17 Audit Plan and following the discussion at the July Audit Committee.***	**Why is this a risk?** When we presented our 2016/17 audit plan to the Audit Committee we had not identified any of the Authority's subsidiaries as a 'significant component' of the group accounts. This means that we were not planning on seeking specific assurances on any of the subsidiaries from either management or their respective auditors. Our planning is an iterative process, and as a result our planned work can be updated at any stage in the audit. When we reviewed the pre-audit results for the subsidiaries, we identified that key aspects of the results for Robin Hood Energy (RHE) had increased significantly compared to the previous year (including turnover and the outturn position). We updated the Audit Committee at the July meeting that we were in the process of updating our risk assessment in terms of VFM arrangements, and the subsequent discussion at the Committee also covered the significance of RHE to the group, and the Committee's arrangements for obtaining assurance on the group as a whole (we have referred to the latter aspect in the VFM conclusion section of this report). **Our work to address this risk** We have liaised with both the Authority and RHE's management in order to gain the necessary understanding of the subsidiary and its expansion. Our revised assessment was that we classified RHE as a significant component. This means that in order to obtain the necessary assurance we have needed to liaise formally with RHE's auditors to enable us to make use of the outcome of their audit (including their opinion) for our audit opinion on the Authority's Group Accounts. We also needed further information and assurances from the Authority in its role as parent. At the time of writing this report we are yet to receive the final audited accounts for RHE and formal confirmation from RHE auditors. We are anticipating receipt of this shortly.

Considerations required by professional standards

Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our *External Audit Plan 2016/17* we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

There are no matters arising from this work that we need to bring to your attention.

Other areas of audit focus

We identified three other areas of audit focus. These are not considered a significant risk as they are less likely to give rise to a material error. Nonetheless these are areas of importance where we would carry out substantive audit procedures to ensure that there is no risk of material misstatement.

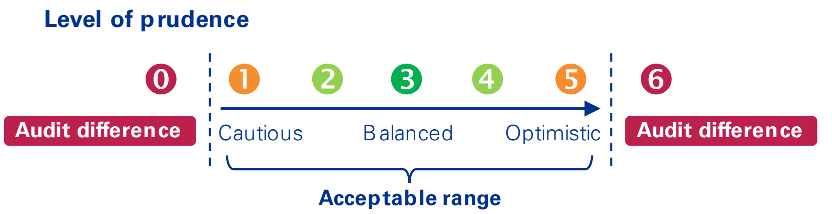
Other areas of audit focus	Our work to address the areas
1. Disclosures associated with retrospective restatement of CIES, EFA and MiRS	**Background** CIPFA has been working with stakeholders to develop better accountability through the financial statements as part of its 'telling the whole story' project. The key objective of this project was to make Local Government accounts more understandable and transparent to the reader in terms of how councils are funded and how they use the funding to serve the local population. The outcome of this project has resulted in two main changes in respect of the 2016-17 Local Government Accounting Code (the Code) as follows: — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MIRS) and replaces the current segmental reporting note. As a result of these changes, retrospective restatement of the CIES (cost of services), EFA and MIRS is required from 1 April 2016 in the Statement of Accounts. The new disclosure requirements and the restatement of the accounts require compliance with relevant guidance and the correct application of applicable Accounting Standards. Though less likely to give rise to a material error in the financial statements, we considered this an important material disclosure change in this year's accounts that we will need to review. **What we have done** For the restatement, we have obtained an understanding of the methodology used to prepare the revised statements. We have also agreed figures disclosed to the Authority's general ledger and found no issues to note.

Other areas of audit focus (cont.)

Other areas of audit focus	Our work to address the areas
2. Property Plant and Equipment (PPE) Valuation	**Background** The Authority is responsible for ensuring the valuation of their PPE is correct, and for conducting impairment reviews that confirm the condition of these assets. As a result of the Authority's accounting policies, this is achieved by performing an annual review for impairment, and a rolling valuation programme. The asset valuation and impairment review processes are both estimates and therefore present a higher level of risk to the audit. Due to the inherent risk associated with the estimation of assets, we consider this to be an issue for review. **What we have done** As part of our audit we have assessed the competence, capability, objectivity and independence of: — the Authority's internal valuer responsible for revaluing Other Land and Buildings; and — the Authority's external valuers, Herbert Button & Partners and Freeman & Mitchell, who have been responsible for undertaking a desktop review in revaluing the Authority's Council Dwellings for 2016/17. We have considered the instructions sent to the valuers and have not highlighted any issues. We note that in revaluing the Authority's Council Dwellings, a vacant possession adjustment factor of 42% has been correctly used, an increase from 34% from the prior year. This has led to a significant revaluation gain recognised within the Comprehensive Income and Expenditure Statement (CIES) of £178.48 million. Given the exceptional nature of this revaluation gain, we agreed with the Authority that this should be separated out on the face of the CIES. We reviewed the revaluation basis of Other Land and Buildings and considered its appropriateness with CIPFA Code of Practice and the underlying IFRS accounting standards.
3. Group Accounts	**Background** Due to the group structure, the Authority will need to ensure its Group Accounts are complete and intra group transactions correctly identified and removed. **What we have done** We reviewed proposed consolidation procedures as part of our interim work, specifically we reviewed all entities over which the Authority has control or significant influence and assessed the Authority's subsequent consideration whether or not to consolidate each entity within the Group Accounts. During our final accounts visit, we have reviewed proposed consolidation of the entities within the Group Accounts based on draft financial statements for each. We have assessed the reasonableness of intra-group transaction adjustments within the primary statements to the group accounts. At the time of writing this report we have not been able to complete our work as we have not received confirmation of the audited accounts of all of the subsidiaries, which officers need to check to see if any changes are needed to their consolidation working papers. This is particularly important for Robin Hood Energy as it is a significant component, as set out earlier in this report.

Judgements

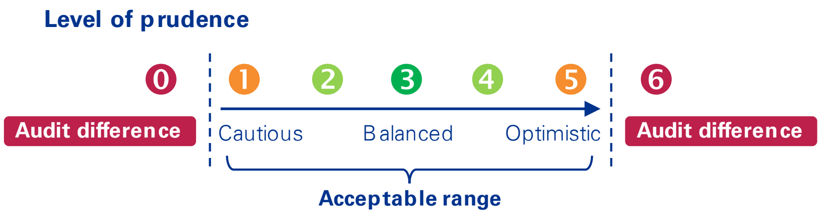
We have considered the level of prudence within key judgements in your 2016/17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016/17	2015/16	Commentary
Provisions (excluding NDR)	3	3	The Authority's provision balance has reduced by £2.99m from the prior year (CY £39.69m, PY £42.67m). As per last year, our review has focussed on the Authority's two key provision balances. Firstly, the provision linked to compulsory purchases associated with the NET2 Tram Scheme (£16.1m). The provision represents outstanding compulsory purchases where the final purchase price is yet to be agreed, the balance has reduced by £1.02m in year as a number of acquisition prices have been agreed. Secondly, the business rates appeals provision (£9.31m). This has reduced slightly from the prior year, as some outstanding appeals have been settled.
Property, Plant and Equipment (valuations / asset lives)	3	3	The Authority's Property, Plant and Equipment (PPE) balance has increased by £206.45m from the prior year. This increase has been primarily driven by a change in the key assumption underpinning the valuation of the Authority's Council Dwellings, the vacant possession adjustment factor. This has increased by 8% in year, driving a significant revaluation gain in the value of Council Dwellings of £178.48 million. The Authority's PPE balance includes: — **Council Dwellings (£835.96m)** – the Authority's portfolio of Council Dwellings, measured at fair value, amounts to 35% of its Property, Plant and Equipment (PPE). In 2016/17 the Authority's continued to apply the guidance on Stock Valuation for Resource Accounting. — **Other Land and Buildings (£794.29m)** - This accounts for 34% of the PPE balance, comprising primarily of operational land and buildings. We have agreed valuations in year and satisfied ourselves where valuation movements are significant. The Authority values its operational land and buildings using either Existing Use Valuation, or Depreciation Replacement Cost if the building is of a specialised nature. — **Infrastructure assets (£494.97m)** – In-line with guidance these are currently recognised at historic cost net of depreciation, and amount to 21% of PPE which we have reviewed and considered reasonable. We judge the valuations above to be balanced, based on the work we have carried out.

Judgements (cont.)

We have considered the level of prudence within key judgements in your 2016/17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.



Subjective areas	2016/17	2015/16	Commentary
Pensions Liability	3	3	The pension deficit within the funded LGPS has increased over the year by £211.76 million. The reported balance (£860.82 million), together with the assumptions and disclosures for inflation, discount rate, salary growth, life expectancy, etc are consistent with the report from the external actuary.

Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's 2016/17 financial statements following approval of the Statement of Accounts by the Audit Committee on 22 September 2017.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality (see Appendix 4 for more information on materiality) level for this year's audit was set at £13 million. Audit differences below £0.65 million are not considered significant.

We identified one non-material classification misstatement, as illustrated on the tables to the right, in regards to the classification of a debtor balance between short and long term. There is no impact on the General Fund or HRA balance. It is our understanding that this will be adjusted in the final version of the financial statements.

We also identified a further non-material misstatement in relation to the classification of an aspect of the NET 2 disclosures that arose from our work this year. Officers have decided not to adjust for this in the final version of the financial statements, but propose to revisit the issue for the purposes of the 2017/18 statements.

In addition we agreed a small number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'). This included separating out a significant revaluation gain in regards to the Authority's Council Dwellings as an exceptional item on the face of the Comprehensive Income and Expenditure Statement. We understand that the Authority will be addressing these.

Annual governance statement

We have reviewed the Authority's 2016/17 Annual Governance Statement and following agreement to suggested amendment, we expect to be able to confirm that:

— It complies with *Delivering Good Governance in Local Government: A Framework published by CIPFA/SOLACE*; and

— It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements. We did identify one amendment which management have made.

Movements on the general fund and HRA 2016/17

£m	Pre-audit	Post-audit
Surplus on the provision of services	109.75	109.75
Adjustments between accounting basis and funding basis under Regulations	(129.61)	(129.61)
Transfers from earmarked reserves to General Fund	17.45	17.45
Decrease in General Fund and HRA	**(2.41)**	**(2.41)**

Balance sheet as at 31 March 2017

£m	Pre-audit	Post-audit	*Ref*[1]
Property, plant and equipment	2,360.67	2,360.67	
Other long term assets	294.27	297.13	*1*
Current assets	150.38	147.52	*1*
Current liabilities	(303.29)	(303.29)	
Long term liabilities	(1,784)	(1,784)	
Net worth	**718.03**	**718.03**	
General Fund	8.46	8.46	
Other usable reserves	214.56	214.56	
Unusable reserves	495	495	
Total reserves	**718.03**	**718.03**	

[1] See referenced adjustments in Appendix 3.

Narrative report

We have reviewed the Authority's 2016/17 Narrative Report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Accounts production and audit process

The Accounts and Audit Regulations 2015 introduces a statutory requirement to produce a draft set of financial statements earlier for the year 2017/18. It also shortens the time available for the audit.

Our audit standards (*ISA 260*) require us to communicate our views on the significant qualitative aspects of the Authority's accounting practices and financial reporting.

We also assessed the Authority's process for preparing the accounts and its support for an efficient audit. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

The Authority has recognised the additional pressures which the earlier closedown in 2017/18 will bring. We have been engaging with the Authority in the period leading up to the year end in order to proactively address issues as they emerge. We consider the Authority's accounting practices to be appropriate.

Completeness of draft accounts

We received a complete set of draft accounts by 12 June 2017 and commenced our audit on the same date, this was ahead of the statutory deadline, 30 June 2017.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) which outlines our documentation request. This helps the Authority to provide audit evidence in line with our expectations.

The quality of working papers provided was high and met the standards specified in our Accounts Audit Protocol.

Response to audit queries

Officers dealt with our audit queries efficiently, responding within appropriate timescales. As a result of this, in the main we were able to complete our on-site work in the agreed timescales with only minor queries outstanding. The issues that have taken longer to resolve have been outside of the standard audit process related to complex accounting issues/operational matters arising from the estimated pension data, clarification of aspects of the NET2 disclosures, and the group relationships as described earlier. Our aim is that working with officers on these issues this year will also help preparations for next year's shorter timescale.

Additional findings in relation to the Authority's control environment for key financial systems

After our interim visit we reported that there were a number of year end controls that we will be testing during our year end audit. We have since completed the testing of these controls and have found no significant issues to note, we have however raised a low priority recommendation regarding the processing of starters on payroll.

We also concluded our General IT controls testing, in which three issues were identified in relation to user access reviews, recording of batch errors within an error log and timely removal of leavers from the Northgate system. We were able to mitigate the potential impact of all three issues.

Prior year recommendations

As part of our audit we specifically follow up the Authority's progress regarding the recommendation in last year's ISA 260 report. The Authority has implemented all recommendations raised in 2015-16, however there continues to be one outstanding recommendation from our 2014/15 ISA 260 report in regards to the having in place a finalised SLA agreement for payroll services with East Midlands Shared Service.

Appendix two provides further details.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our Annual Audit Letter and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of Nottingham City Council for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and the Authority, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 5 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Director of Strategic Finance for presentation to the Audit Committee.

We require a signed copy of your management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

— Significant difficulties encountered during the audit;

— Significant matters arising from the audit that were discussed, or subject to correspondence with management;

— Other matters, if arising from the audit that, in the auditor's professional judgement, are significant to the oversight of the financial reporting process; and

— Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2016/17 financial statements.

Section two

Value for money

Our 2016/17 VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We have concluded that the Authority has made proper arrangements to ensure it took properly-informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

VFM conclusion

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions, worked with partners and other third parties and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

1 Identification of significant VFM risks (if any)

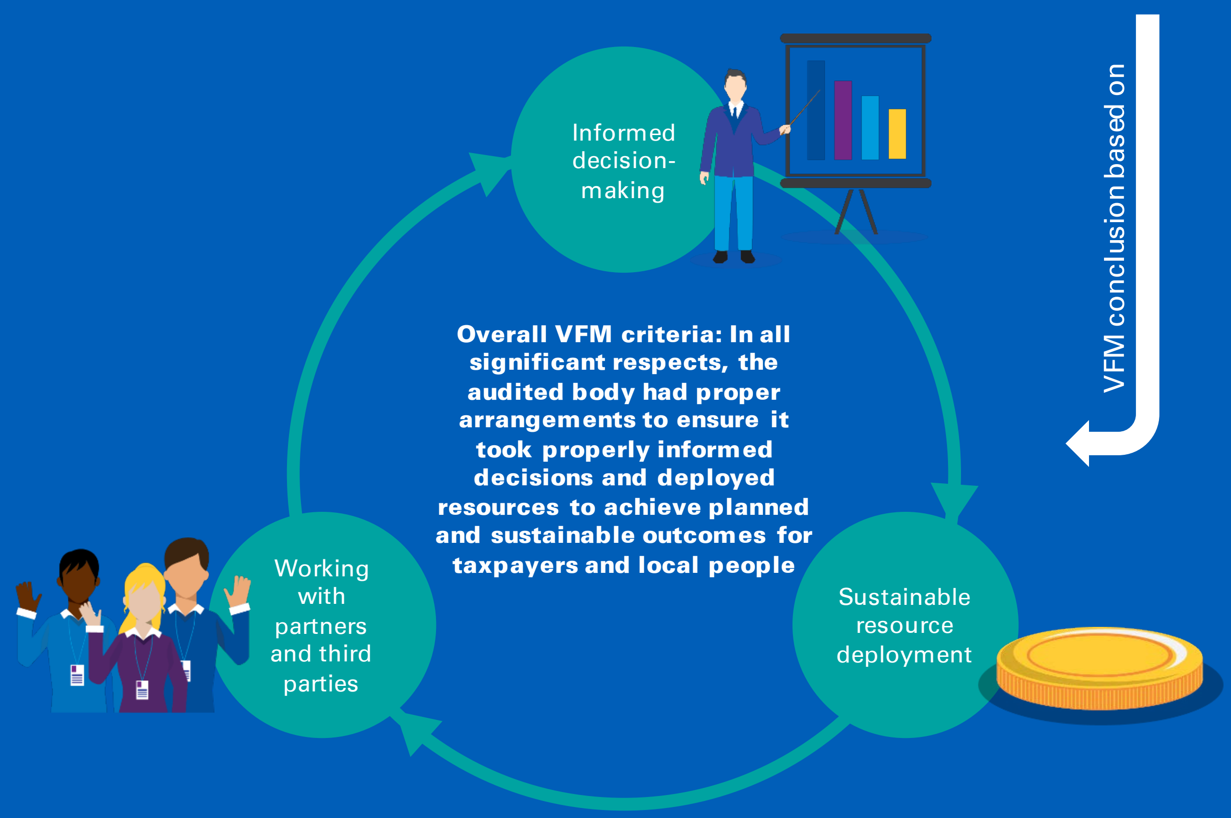
- VFM audit risk assessment
- Financial statements and other audit work

2 Continually re-assess potential VFM risks

- Assessment of work by other review agencies
- Specific local risk-based work

3 VFM conclusion

- **Conclude on arrangements to secure VFM**



The table below summarises our assessment of the individual VFM risk identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

VFM assessment summary			
VFM risk	**Informed decision-making**	**Sustainable resource deployment**	**Working with partners and third parties**
1. Financial sustainability, including medium term financial planning and the delivery of savings plans.	✓	✓	✓
2. Group Governance, including Wholly Owned Trading Companies	✓	✓	✓
Overall summary	✓	✓	✓

In consideration of the above, we have concluded that in 2016/17, the Authority has made proper arrangements to ensure it took properly-informed decisions, worked with partners and other third parties, and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Further details on the work done and our assessment are provided on the following pages.

Significant VFM risks

We have identified one significant VFM risks, as communicated to you in our *2016/17 External Audit Plan*. In this case we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to this risk area is adequate.

Significant VFM risks	Work performed
1. Financial resilience in the local and national economy	**Why is this a risk?** As reported in the Authority's medium term financial plan in February 2016, central government's settlement funding for the Authority has reduced by £119m since 2010/11, however further financial challenges lie ahead. On the back of the Local Government Settlement, there will be future funding impacts, for example on the New Homes Bonus. The Authority forecasts further savings will need to be found as the Authority faces further expenditure pressures and a continued reduction in resources includes proposed savings of £19.8m 2016/17. Therefore we consider this as a significant risk. **Summary of our work** In line with the rest of the sector, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. In reaching our VFM conclusion we have considered the Authority's arrangements for making properly informed decisions, sustainable resource deployment and working with partners and third parties. This has included detailed reviews of key documents including the Medium Term Financial Plan, including the 2016/17 General Fund Revenue Budget and corresponding outturn report, and the Local Government Funding Settlement. We have reviewed the Authority's financial performance and position for the 2016/17 year. Although historically the Authority has a good track record of delivering its budget and savings plans, we note that for 2016/17 the Authority has recognised a net overspend of £2.52m. The net overspend is indicative of worsening financial pressures, notably in regards to demand led services, primarily stemming from adult and child care services. As part of the budget process for 2017/18, we noted that the Authority included an expected £10m of additional resource arising from the health integration process, based on the Nottingham and Nottinghamshire Sustainability and Transformation Plan (STP). We raised concerns with the Audit Committee (February meeting) and with officers in terms of reliance on this to meet the 2017/18 budget. We note that officers reported to Executive Board on 19 September that the anticipated additional resources from health integration are to be removed from the 2017/18 budget, and also from 2018/19 and 2019/20. The Authority is working to mitigate the resulting overspend. However, along with further budget pressures from Adults and Health and Early Intervention and Early Years, the result is currently a projection without further action of a likely year-end overspend of £7.8m. In coming to our assessment on the Authority's overall arrangements we have taken into account that officers are working on the options to address this projection in terms of 2017/18 actual outturn (planned outturn is a deficit of £0.858m following intended actions with the aim of breaking even) and the impact on future years. We note that the actions include non-recurrent measures that will not address the revised expectation that health integration will not provide additional resources. We will revisit the arrangements in place as part of our 2017/18 VFM work.

Significant VFM risks (cont.)

Significant VFM risks	Work performed
2. Group Governance, including Wholly Owned Trading Companies ***Please note we added this risk to our audit programme after we had issued our 2016/17 Audit Plan and following the discussion at the July Audit Committee.***	**Why is this a risk?** During 2016/17 the Authority included the following risk within its Strategic Risk Register: **Risk:** *The creation and running of wholly owned trading companies.* **Description:** *Lack of transparent and robust governance arrangements that protect the interests of the Council.* **Potential Impact:** *Failure of a wholly owned company has a financial cost and reputational impact; may adversely affect future trading for other council owned companies due to loss of confidence; disrupts services provided to citizens.* At the July 2017 Committee meeting, we communicated that we had identified the potential for a new Value For Money risk linked to the Authority's wider group structure. Specifically, as noted earlier in this report, when we reviewed the pre-audit results for the Authority's subsidiaries, we identified that key aspects of the results for Robin Hood Energy (RHE) had increased significantly compared to the previous year (including turnover and the outturn position), however we required further understanding of underlying governance arrangements. **Summary of our work** We have liaised with both the Authority and RHE's management in order to gain the necessary understanding of the subsidiary. Our revised assessment was that we classified RHE as a significant component. This means that in order to obtain the necessary assurance we needed to liaise with RHE's auditors to enable us to make use of the outcome of their audit (including their opinion) for our audit opinion on the Authority's Group Accounts. We also needed further information and assurances from the Authority in its role as parent. In regards to the wider Group governance we note that, following our discussions and agreement at the July Audit Committee, the Authority is commencing an internal review in regards to Group governance, and the Terms of Reference for this review are scheduled to be presented and agreed with Audit Committee on 22 September.

Appendices

Key issues and recommendations

Our audit work on the Authority's 2016/17 financial statements has identified four recommendations. We have listed these in our appendix. We have also included Management's responses to these recommendations.

The Authority should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.

Medium priority — Issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

2016/17 recommendations summary

Priority	Total raised for 2016/17
High	-
Medium	1
Low	3
Total	4

Medium priority

1. Northgate Leavers

We performed a comparison against leavers from the Authority and users with Access to the Northgate system. We identified 11 users who had left the Authority but continued to still be set-up with access on the Northgate system.

There were in place mitigations, and all leavers had their Windows Network access removed. If a user does not access the system for 35 days then their account is automatically locked.

The leavers had access to Northgate as their manager has not informed IT, and Northgate is yet to fully integrate with the HR leavers process.

Recommendation

The Authority should ensure all leavers with access to Northgate are removed immediately. The Northgate system should be integrated into the HR leaver process and manager reminded to notify IT that Northgate access needs to be revoked on leaving the Authority.

Management Response

TBC

Owner

TBC

Deadline

TBC

Low priority	**2. General Ledger Batch Controls** East Midland Shared Service (EMSS) operate a control whereby if a general ledger batch job fails, it is added to an error log, given a unique ID and tracked as the EMSS team resolve and find a solution. As part of our audit of General IT Controls, we noted that whilst batch job fails were being resolved, they had not been logged for the second half of the year (from September 2016.) **Recommendation** The Authority should continue to log all general ledger batch control fails in the error log.	**Management Response** TBC **Owner** TBC **Deadline** TBC
Low priority	**3. Processing of new joiners on payroll** As part of this process there is a check performed by payroll to ensure that the information entered by HR into the payroll system is accurate. As part of our audit testing we noted that for one individual, there was no evidence that this check had been performed. Through discussion it has been confirmed that the process varies slightly dependent upon the individual within the payroll team who is setting up the new joiner or making the amendment. The checks are always performed by payroll, however some individuals do not print off the E-form, add ticks to evidence the check and sign it to show that the check has been complete. Therefore there is no evidence that these checks have taken place. **Recommendation** The Authority should ensure consistency in regards to processing of new joiners and that controls support the accuracy of data input into the payroll system.	**Management Response** TBC **Owner** TBC **Deadline** TBC
Low priority	**4. Northgate Access Reviews** Annual reviews of user access on the Northgate system do not take place, we were informed that it is picked up typically when there is a major system upgrade, approximately every five years. Best practice states that when individual staff change positions or leave, their manager should inform IT of the change of role so that access rights can be changed to match those of a "profiler" (i.e. somebody who already has the access they now need). There should be annual reviews of what access groups need to be able to do. **Recommendation** The Authority should undertake regular user access reviews in regards to the Northgate system.	**Management Response** TBC **Owner** TBC **Deadline** TBC

Follow-up of prior year recommendations

In the previous year, we raised five recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. The Authority has implemented all of the recommendations. There is one recommendation outstanding from 2014-15. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented by the Authority.

We have used the same rating system as explained in Appendix 1.

Each recommendation is assessed during our 2016/17 work, and we have obtained the recommendation's status to date. We have also obtained Management's assessment of each outstanding recommendation.

Below is a summary of the current position on the prior year's recommendations (including the b/f 2014/15 issue).

2015/16 recommendations status summary

Priority	Number raised	Number implemented / superseded	Number outstanding
High	1	0	**1**
Medium	5	5	**0**
Low	0	0	**0**
Total	**6**	**5**	**1**

High priority

1. Control weaknesses in EMSSS over payroll (2014/15 rec carried forward)

Throughout work on payroll we identified that EMSS do not undertake a payroll reconciliation for Nottingham City Council although they do this for Leicester County Council.

Exception reports, one of the outputs from payroll are not checked by EMSS.

We expect that the responsibilities of EMSS should be set out in an Service Level Agreement to enable both parties to be clear what tasks should be carried out by each party.

Recommendation

Nottingham City Council and East Midlands Shared Service should set up a Service Level Agreement as soon as possible.

Management original response

Responsibility for the reconciliations has been passed over to EMSS.

An SLA with EMSS is in the process of being set up.

Owner

Head of Corporate and Strategic Finance

Original deadline

31 December 2015

KPMG's September 2017 assessment

Partially implemented

The Authority has actively pursued setting up a SLA in year. We have reviewed the latest version of the SLA, however this still has items under discussion and is pending final agreement.

Priority	Issue and recommendation	Management original response
Medium priority	**2. Better Care Fund 2016-17 Plan** The Better Care Fund ended the year with an underspend of £2.4m. While the Programme Board recognised this early in year and worked to reallocate the underspend, the nature of the majority of the funding from NHS England puts any year-end underspend at risk. **Recommendation** The Authority should enhance the narrative statement in 2016/17 based on feedback provided by External Audit in 2015/16 and best practice.	Plans are already underway to work with BCF partners to ensure that all available resources are matched to valid schemes which will improve the health and social care of Nottingham citizens. Regular reports will be presented to the Well Being Board to update on the ongoing position. *Original deadline* Immediate **KPMG's September 2017 assessment** Implemented
Medium priority	**3. Oracle User Access Reviews** As part of our IT controls testing we identified that through 2015/16 there was no documented review of user access rights to ensure that these remain appropriate. Officers informed us that this was a control they are intending to implement in 2016/17. **Recommendation** The Authority should ensure that user access reviews are undertaken in regards to key financial systems throughout the Authority, including the Oracle system.	User access rights are controlled and discussions are currently under way to set the process to document the review of these user access rights. For 2016/17 there will be an agreed process and plan to document and evidence the review. *Original deadline* Immediate **KPMG's September 2017 assessment** Implemented
Medium priority	**4. Northgate to Oracle NNDR and Council Tax Reconciliations** Through out our controls testing we noted that the reconciliations in place for Northgate and Oracle are not robustly documented. We would expect to see a high level reconciliation carried out each month which demonstrates, for example, the Council Tax charge per Northgate correctly reconciles to Oracle. **Recommendation** The Authority should perform and document month end reconciliations between NNDR and Council Tax modules of the Northgate system to Oracle.	For 2016/17 the reconciliation which will be carried out monthly will be formally documented and signed off by a manager at the end of each month. *Original deadline* Immediate **KPMG's September 2017 assessment** Implemented

Medium priority

5. 2016/17 Northgate to Oracle Housing Benefit Payment Reconciliations

We discussed housing benefit payment reconciliations with key staff and noted that since April 2016 to the time of writing, no reconciliations have been performed to reconcile Northgate housing benefit payments to actual payments as per Oracle. We understand that this is following a change in process and on hold due to a training requirement to understand how to directly extract Oracle payments to feed into the reconciliation (in 2015/16 payments were extracted via the OneWorld system).

Recommendation

The Authority should expedite the implementation of the reconciliation of housing benefit payments between Northgate and Oracle.

Management original response

For 2016/17 the reconciliation which will be carried out monthly will be formally documented and signed off by a manager at the end of each month.

Original deadline

Immediate

KPMG's September 2017 assessment

Implemented

Medium priority

6. Register of Members' Interests

As part of our testing on related parties, we noted that the register of interests provided for audit showed that 55% of members had completed their annual declaration –this increased to 78% after the Authority made follow-up inquiries.

It is good practice for all members to make an annual declaration. It is a criminal offence not to declare a pecuniary interest as per the Localism Act 2011.

Recommendation

The Authority should ensure that all members make an annual declaration to update the register of interests.

Management original response

For 2016/17 we will use the Register of Interests held by Committee Services to collate our information. We plan to request the additional information required for the Statement of Accounts from Councillors in December. We will send the completed Related Parties form to Councillors at year end for review and confirmation and if necessary to allow them to make changes for any change of circumstances arising between December and March.

Original deadline

Immediate

KPMG's September 2017 assessment

Implemented

Appendix 3

Audit differences

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

A number of minor amendments focused on presentational improvements have also been made to the 2016/17 draft financial statements. The Finance team is committed to continuous improvement in the quality of the financial statements submitted for audit in future years.

Adjusted audit differences

The following table sets out the significant audit differences identified by our audit of Nottingham City's financial statements for the year ended 31 March 2017. It is our understanding that these will be adjusted in the final set of financial statements.

Table 1: Adjusted audit differences (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1			Dr Long Term Debtors 2,858 Cr Short Term Debtors 2,858			Reclassification error of the debtor balance linked to the NET 2 PFI scheme, between long and short term debtors
			Dr/Cr 0			**Total impact of adjustments**

Unadjusted audit differences

The following table sets out the uncorrected audit differences identified by our audit of Nottingham City Council's financial statements for the year ended 31 March 2017. These differences are individually below our materiality level of £13m. Cumulatively, the impact of these uncorrected audit differences is £8.67m. We have also considered the cumulative impact of these unadjusted audit differences on the Authority's financial statements in forming our audit opinion.

Table 2: Unadjusted audit differences (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1			Cr Short Term Debtors 510 Cr Long Term Debtors 8,158	Dr Other Long Term Liabilities 8,668		Deferral of capital contributions made during the construction phase of the NET2 contract, given nature of the expenditure we consider that this should be written down against the liability.
			Cr £8,668	**Dr £8,668**		**Total impact of uncorrected audit differences**

Materiality and reporting of audit differences

The assessment of what is material is a matter of professional judgement and includes consideration of three aspects: materiality by value, nature and context.

Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2016/17, presented to you in March 2017.

Materiality for the Authority's accounts was set at £13 million. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under *ISA 260*, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. *ISA 260* defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £650,000 for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

> *"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."*

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd Terms of Appointment ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 Integrity, Objectivity and Independence ('Ethical Standards').

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Public Sector Audit Appointments Ltd guidance requires appointed auditors to follow the provisions of *ISA (UK&I) 260 'Communication of Audit Matters with Those Charged with Governance'* that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our Annual Audit Letter.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Nottingham City Council for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and the Authority, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work

Description of non-audit service and fees billed in 2016/17	Fees Billed in 2016/17	Potential threat to auditor independence and associated safeguards in place
Additional certification work in regards to Pooling of Capital Receipts Return	£4,000	**Self-interest**: These engagements are entirely separate from the audit through a separate contract. In addition, the audit fee scale rates were set independently to KPMG by the PSAA (previously Audit Commission). Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self review**: The nature of this other 'assurance' work has no impact on the 2016/17 audit as it relates to 2015/16 financial year. Therefore, it does not impact on our opinion and we do not consider it to be a threat to our role as external auditors. **Management threat**: This work involved the certification of these returns only –all decisions were made by the Authority. **Familiarity**: This threat is limited given the scale, nature and timing of the work. **Advocacy**: We will not act as advocates for the Authority in any aspect of this work. We have drawn on our experience in such roles to certify the returns but the scope of this work falls well short of any advocacy role **Intimidation:** Not applicable.
Additional certification work in regards to Local Transport Grant	£3,000	
Additional certification work in regards to Teachers Pension Return	£3,200	
Additional certification work in regards to SFA subcontracting	£3,000	
Total	£13,200	7.7% of the audit fee

Appendix 6

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit is £172,118 plus VAT *(£172,118 in 2015/16)*, which is the same as the prior year. However, we the process of agreeing an additional fee in respect of work undertaken in relation to the Group Accounts, CIES restatement, NET 2 issues, and the impact of estimated data provided for the triennial pension revaluation.

Our work on the certification of Housing Benefits (BEN01) is not yet complete. The planned scale fee for this is £10,965 plus VAT, however we are undertaking significantly more testing this year following the issues identified in 2015/16.

Fee table		
Component of audit	**2016/17** *(planned fee)* *£*	**2015/16** *(actual fee)* *£*
Accounts opinion and use of resources work		
Scale Fee	172,118	172,118
Additional work to conclude our opinion (note 1)	TBC	4,975
Subtotal	**172,118***	**177,093**
Housing benefits (BEN01) certification work	10,965*	18,458
Other grants and claims (per previous page)	13,200	12,900
Total fees	**196,283**	**208,451**

All fees are quoted exclusive of VAT.

Note 1: Accounts opinion and use of resources work

For 2016/17, we will discuss additional fee in relation to the work undertaken in respect of the issues raised above. This will be subject to final agreement and PSAA approval.

In 2015/16, the PSAA approved a fee variation of £4,975 in relation to our review of the Adducure.

***Does not include the additional fee re note 1**